

ASSEMBLY BILL

No. 1674

Introduced by Assembly Members Dutra and Nakano

February 21, 2003

An act to amend Sections 6377, 17053.49, and 23649 of, the Revenue and Taxation Code, relating to taxation, and making an appropriation therefor, to take effect immediately, tax levy.

LEGISLATIVE COUNSEL'S DIGEST

AB 1674, as introduced, Dutra. Sales and use tax exemption: income and corporation tax credits: manufacturing.

The Sales and Use Tax Law imposes a tax on the gross receipts from the sale in this state of, or the storage, use, or other consumption in this state of, tangible personal property, and provides various exemptions from the taxes imposed by that law. That law provides an exemption from those taxes for the gross receipts from the sale of, and the storage, use, or other consumption of, tangible personal property, as defined, purchased for use by a qualified person, as defined, in manufacturing, processing, refining, fabricating, or recycling of property, and introduced into the process, as specified. That law also provides that this exemption will cease to be operative on January 1, 2001, or on January 1 of the earliest year thereafter, if total employment, as defined, in California does not exceed by 100,000 jobs the total employment in California on January 1, 1994.

This bill would expand the definition of qualified person to include persons engaged in specified lines of business, extend the exemption to tangible personal property purchased for use by a qualified person to be used primarily for telecommunications, allow the exemption in addition to certain income and corporation tax credits, and delete the

provisions rendering the exemption inoperative. This bill would provide that, for purchases made in 2004 and 2005, the exemption be implemented through a refund procedure commencing in 2006, and would make an appropriation for the payment of those refunds from the General Fund.

The Personal Income Tax Law and the Bank and Corporation Tax Law authorize various credits against the taxes imposed by those laws, including a credit against taxes imposed by those laws in an amount equal to 6% of the qualified cost paid or incurred during the taxable year for qualified property, as defined, that is placed in service in this state.

This bill would delete a condition for the classification of costs as qualified costs.

This bill would take effect immediately as a tax levy, but certain of its provisions would become operative on January 1, 2004.

Vote: ²/₃. Appropriation: yes. Fiscal committee: yes. State-mandated local program: no.

The people of the State of California do enact as follows:

1 SECTION 1. Section 6377 of the Revenue and Taxation Code
2 is amended to read:

3 6377. (a) There are exempted from the taxes imposed by this
4 part the gross receipts from the sale of, and the storage, use, or
5 other consumption in this state of, any of the following:

6 (1) Tangible personal property purchased for use by a qualified
7 person to be used primarily in any stage of the manufacturing,
8 processing, refining, fabricating, or recycling of property,
9 beginning at the point any raw materials are received by the
10 qualified person and introduced into the process and ending at the
11 point at which the manufacturing, processing, refining,
12 fabricating, or recycling has altered property to its completed
13 form, including packaging, if required.

14 (2) Tangible personal property purchased for use by a qualified
15 person to be used primarily in research and development.

16 (3) *Tangible personal property purchased for use by a qualified*
17 *person to be used primarily for telecommunications.*

18 (4) Tangible personal property purchased for use by a qualified
19 person to be used primarily to maintain, repair, measure, or test any
20 property described in paragraph (1), ~~or~~ (2), or (3).

21 ~~(4)~~

(5) Tangible personal property purchased for use by a contractor purchasing that property either as an agent of a qualified person or for the contractor's own account and subsequent resale to a qualified person for use in the performance of a construction contract for the qualified person who will use the tangible personal property as an integral part of the manufacturing, processing, refining, fabricating, or recycling process, or as a research or storage facility for use in connection with the manufacturing process.

This exemption shall not apply to any tangible personal property that is used primarily in administration, general management, or marketing.

(b) For purposes of this section:

(1) "Fabricating" means to make, build, create, produce, or assemble components or property to work in a new or different manner.

(2) "Manufacturing" means the activity of converting or conditioning property by changing the form, composition, quality, or character of the property for ultimate sale at retail or use in the manufacturing of a product to be ultimately sold at retail. Manufacturing includes any improvements to tangible personal property that result in a greater service life or greater functionality than that of the original property.

(3) "Primarily" means tangible personal property used 50 percent or more of the time in an activity described in subdivision (a).

(4) "Process" means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer's manufacturing, processing, refining, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer's manufacturing, processing, refining, fabricating, or recycling activity is

1 conducted, shall not be considered to have been introduced into the
2 manufacturing, processing, refining, fabricating, or recycling
3 process.

4 (5) “Processing” means the physical application of the
5 materials and labor necessary to modify or change the
6 characteristics of property.

7 (6) “Qualified person” means any person that is ~~both of the~~
8 ~~following:~~

9 ~~(A) A new trade or business. In determining whether a trade or~~
10 ~~business activity qualifies as a new trade or business, the following~~
11 ~~rules shall apply:~~

12 ~~(i) In any case where a person purchases or otherwise acquires~~
13 ~~all or any portion of the assets of an existing trade or business~~
14 ~~(irrespective of the form of entity) that is doing business in this~~
15 ~~state (within the meaning of Section 23101), the trade or business~~
16 ~~thereafter conducted by that person (or any related person) shall~~
17 ~~not be treated as a new business if the aggregate fair market value~~
18 ~~of the acquired assets (including, real, personal, tangible, and~~
19 ~~intangible property) used by that person (or any related person) in~~
20 ~~the conduct of his or her trade or business exceed 20 percent of the~~
21 ~~aggregate fair market value of the total assets of the trade or~~
22 ~~business being conducted by the person (or any related person).~~
23 ~~For purposes of this subparagraph only, the following rules shall~~
24 ~~apply:~~

25 ~~(I) The determination of the relative fair market values of the~~
26 ~~acquired assets and the total assets shall be made as of the last day~~
27 ~~of the month following the quarterly period in which the person (or~~
28 ~~any related person) first uses any of the acquired trade or business~~
29 ~~assets in his or her business activity.~~

30 ~~(II) Any acquired assets that constituted property described in~~
31 ~~Section 1221(1) of the Internal Revenue Code in the hands of the~~
32 ~~transferor shall not be treated as assets acquired from an existing~~
33 ~~trade or business, unless those assets also constitute property~~
34 ~~described in Section 1221(1) of the Internal Revenue Code in the~~
35 ~~hands of the acquiring person (or related person).~~

36 ~~(ii) In any case where a person (or any related person) is~~
37 ~~engaged in one or more trade or business activities in this state, or~~
38 ~~has been engaged in one or more trade or business activities in this~~
39 ~~state within the preceding 36 months (“prior trade or business~~
40 ~~activity”), and thereafter commences an additional trade or~~

~~business activity in this state, the additional trade or business activity shall only be treated as a new business if the additional trade or business activity is classified under a different division of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition, than are any of the person's (or any related person's) current or prior trade or business activities in this state.~~

~~(iii) In any case where a person, including all related persons, is engaged in trade or business activities wholly outside of this state and that person first commences doing business in this state (within the meaning of Section 23101) after December 31, 1993 (other than by purchase or other acquisition described in clause (i)), the trade or business activity shall be treated as a new business.~~

~~(iv) In any case where the legal form under which a trade or business activity is being conducted is changed, the change in form shall be disregarded and the determination of whether the trade or business activity is a new business shall be made by treating the person as having purchased or otherwise acquired all or any portion of the assets of an existing trade or business under the rules of clause (i).~~

~~(v) "Related person" means any person that is related to that person under either Section 267 or 318 of the Internal Revenue Code.~~

~~(vi) "Acquire" includes any gift, inheritance, transfer incident to divorce, or any other transfer, whether or not for consideration.~~

~~(B) Engaged in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition.~~

~~(7) Notwithstanding paragraph (6), "qualified person" shall not include any person who has conducted business activities in a new trade or business for three or more years.~~

~~(8) engaged in those lines of business described in Codes 2011 to 3999, inclusive, 4812 to 4899, inclusive, 7371 to 7373, inclusive, and 8731 of the Standard Industrial Classification Manual published by the United States Office of Management and Budget, 1987 edition.~~

~~(7) "Refining" means the process of converting a natural resource to an intermediate or finished product.~~

~~(9)~~

1 (8) “Research and development” means those activities that
2 are described in Section 174 of the Internal Revenue Code or in any
3 regulations thereunder.

4 ~~(10)–~~

5 (9) “Tangible personal property” does not include any of the
6 following:

7 (A) Consumables with a normal useful life of less than one
8 year, except as provided in subparagraph (E) of paragraph (10).

9 (B) Furniture, inventory, equipment used in the extraction
10 process, or equipment used to store finished products that have
11 completed the manufacturing process.

12 ~~(C) Any property for which a credit is claimed under either~~
13 ~~Section 17053.49 or 23649.~~

14 ~~(11)–~~

15 (10) “Tangible personal property” includes, but is not limited
16 to, all of the following:

17 (A) Machinery and equipment, including component parts and
18 contrivances such as belts, shafts, moving parts, and operating
19 structures.

20 (B) All equipment or devices used or required to operate,
21 control, regulate, or maintain the machinery, including, without
22 limitation, computers, data processing equipment, and computer
23 software, together with all repair and replacement parts with a
24 useful life of one or more years therefor, whether purchased
25 separately or in conjunction with a complete machine and
26 regardless of whether the machine or component parts are
27 assembled by the taxpayer or another party.

28 (C) Property used in pollution control that meets or exceed
29 standards established by this state or any local or regional
30 governmental agency within this state.

31 (D) Special purpose buildings and foundations used as an
32 integral part of the manufacturing, processing, refining, or
33 fabricating process, or that constitute a research or storage facility
34 used during the manufacturing process. Buildings used solely for
35 warehousing purposes after completion of the manufacturing
36 process are not included.

37 (E) Fuels used or consumed in the manufacturing process.

38 (F) Property used in recycling.

39 (c) No exemption shall be allowed under this section unless the
40 purchaser furnishes the retailer with an exemption certificate,

completed in accordance with any instructions or regulations as the board may prescribe, and the retailer subsequently furnishes the board with a copy of the exemption certificate. The exemption certificate shall contain the sales price of the machinery or equipment that is exempt pursuant to subdivision (a).

(d) Notwithstanding any provision of the Bradley-Burns Uniform Local Sales and Use Tax Law (Part 1.5 (commencing with Section 7200)) or the Transactions and Use Tax Law (Part 1.6 (commencing with Section 7251)), the exemption established by this section shall not apply with respect to any tax levied by a county, city, or district pursuant to, or in accordance with, either of those laws, *unless approved by the local government that would otherwise receive the sales tax.*

(e) (1) Notwithstanding subdivision (a), the exemption provided by this section shall not apply to any sale or use of property which, within one year from the date of purchase, is either removed from California or converted from an exempt use under subdivision (a) to some other use not qualifying for the exemption.

(2) Notwithstanding subdivision (a), on or after January 1, 1995, the exemption established by this section shall not apply with respect to any tax levied pursuant to Sections 6051.2 and 6201.2, or pursuant to Section 35 of Article XIII of the California Constitution.

(f) If a purchaser certifies in writing to the seller that the property purchased without payment of the tax will be used in a manner entitling the seller to regard the gross receipts from the sale as exempt from the sales tax, and within one year from the date of purchase, the purchaser (1) removes that property outside California, (2) converts that property for use in a manner not qualifying for the exemption, or (3) uses that property in a manner not qualifying for the exemption, the purchaser shall be liable for payment of sales tax, with applicable interest, as if the purchaser were a retailer making a retail sale of the property at the time the property is so removed, converted, or used, and the sales price of the property to the purchaser shall be deemed the gross receipts from that retail sale.

~~(g) (1) This section shall remain in effect until the date specified in paragraph (2), on which date this section shall cease to be operative, and as of that date is repealed.~~

~~(2) (A) This section shall cease to be operative on January 1, 2001, or on January 1 of the earliest year thereafter, if the total employment in this state, as determined by the Employment Development Department on the preceding January 1, does not exceed by 100,000 jobs the total employment in this state on January 1, 1994. The department shall report annually to the Legislature with respect to the determination required by the preceding sentence.~~

~~(B) For purposes of this paragraph, "total employment" means the total employment in the manufacturing sector, excluding employment in the aerospace sector.~~

~~(h) This section applies to leases of tangible personal property classified as "continuing sales" and "continuing purchases" in accordance with Sections 6006.1 and 6010.1. The exemption established by this section shall apply to the rentals payable pursuant to such a lease, provided the lessee is a qualified person and the property is used in an activity described in subdivision (a). Rentals which meet the foregoing requirements are eligible for the exemption for a period of six years from the date of commencement of the lease. At the close of the six-year period from the date of commencement of the lease, lease receipts are subject to tax without exemption.~~

~~(h) The sales tax exemption allowed by this section may be claimed in addition to claiming the manufacturers investment credit allowed by Section 17053.49 or 23469.~~

~~(i) (1) The granting of exemptions pursuant to this section for purchases made in 2004 or 2005 shall be postponed until after January 1, 2006, and shall be granted thereafter in the form of a refund to a qualified person, only upon submission by a qualified person of a claim for refund to, and acceptance of the claim by, the board, as provided in paragraph (2).~~

~~(2) A qualified person who has paid sales tax reimbursement to a retailer or use tax on a purchase or purchases of property for which an exemption is allowed pursuant to this section for purchases made in 2004 or 2005, may file a claim for refund equal to the tax on the exempt amount that would otherwise be allowed pursuant to this section. Any claim so filed shall be submitted to the board on a form prescribed by the board, and may be filed no earlier than the date of the transaction for which a sales tax exemption under this section is allowed. A claim for refund shall,~~

1 *unless the sale or use of the property is otherwise exempt under this*
2 *part, be accompanied by proof of payment of the tax to a retailer,*
3 *including, but not limited to, a copy of an invoice or purchase*
4 *contract that indicates the following:*

5 (A) *The date on which the purchase occurred.*

6 (B) *A description of the property purchased.*

7 (C) *The price paid for the property.*

8 (D) *The amount of tax paid with respect to the purchase.*

9 (3) *In the case of a person who has self-reported use tax to the*
10 *board, the claim for refund shall also indicate the amount of use*
11 *tax paid and the period for which that tax was remitted.*

12 (4) *Interest shall be paid on any refund made pursuant to this*
13 *section.*

14 (5) *Notwithstanding Section 6961, the board may recover any*
15 *refund or part thereof that is erroneously made pursuant to this*
16 *section. In recovering any erroneous refund made pursuant to this*
17 *section, the board, in its discretion, may issue a deficiency*
18 *determination in accordance with Article 2 (commencing with*
19 *Section 6481) of Article 4 (commencing with Section 6536) of*
20 *Chapter 5. Except in the case of fraud, that determination shall be*
21 *made within three years from the last day of the month following*
22 *the quarterly period in which the board approved the refund.*

23 (6) *Any refund approved by the board pursuant to this section*
24 *shall be payable from the General Fund.*

25 (7) *Notwithstanding Section 13340 of the Government Code,*
26 *the amount necessary for the payment of refunds approved under*
27 *this subdivision is hereby appropriated, without reference to fiscal*
28 *year, from the General Fund to the State Board of Equalization for*
29 *the payment of those refunds.*

30 SEC. 2. Section 17053.49 of the Revenue and Taxation Code
31 is amended to read:

32 17053.49. (a) (1) A qualified taxpayer shall be allowed a
33 credit against the “net tax,” as defined in Section 17039, equal to
34 6 percent of the qualified cost of qualified property that is placed
35 in service in this state.

36 (2) In the case of any qualified costs paid or incurred on or after
37 January 1, 1994, and prior to the first taxable year of the qualified
38 taxpayer beginning on or after January 1, 1995, the credit provided
39 under paragraph (1) shall be claimed by the qualified taxpayer on
40 the qualified taxpayer’s return for the first taxable year beginning

1 on or after January 1, 1995. No credit shall be claimed under this
2 section on a return filed for any taxable year commencing prior to
3 the qualified taxpayer's first taxable year beginning on or after
4 January 1, 1995.

5 (b) (1) For purposes of this section, "qualified cost" means
6 any cost that satisfies each of the following conditions:

7 (A) Except as otherwise provided in this subparagraph, is a cost
8 paid or incurred by the qualified taxpayer for the construction,
9 reconstruction, or acquisition of qualified property on or after
10 January 1, 1994, and prior to the date this section ceases to be
11 operative under paragraph (2) of subdivision (i). In the case of any
12 qualified property constructed, reconstructed, or acquired by the
13 qualified taxpayer (or any person related to the qualified taxpayer
14 within the meaning of Section 267 or 707 of the Internal Revenue
15 Code) pursuant to a binding contract in existence on or prior to
16 January 1, 1994, costs paid pursuant to that contract shall be
17 subject to allocation as follows: contract costs shall be allocated to
18 qualified property based on a ratio of costs actually paid prior to
19 January 1, 1994, and total contract costs actually paid. "Cost paid"
20 shall include, without limitation, contractual deposits and option
21 payments. To the extent of costs allocated, whether or not currently
22 deductible or depreciable for tax purposes, to a period prior to
23 January 1, 1994, the cost shall be deemed allocated to property
24 acquired before January 1, 1994, and is thus not a "qualified cost."

25 ~~(B) Except as provided in paragraph (3) of subdivision (d) and~~
26 ~~subparagraph (B) of paragraph (4) of subdivision (d), is an amount~~
27 ~~upon which the qualified taxpayer has paid, directly or indirectly,~~
28 ~~as a separately stated contract amount or as determined from the~~
29 ~~records of the qualified taxpayer, sales or use tax under Part 1~~
30 ~~(commencing with Section 6001):~~

31 ~~(C) Is an amount properly chargeable to the capital account of~~
32 ~~the qualified taxpayer.~~

33 (2) (A) For purposes of this subdivision, any contract entered
34 into on or after January 1, 1994, that is a successor or replacement
35 contract to a contract that was binding prior to January 1, 1994,
36 shall be treated as a binding contract in existence prior to January
37 1, 1994.

38 (B) If a successor or replacement contract is entered into on or
39 after January 1, 1994, and the subject of the successor or
40 replacement contract relates both to amounts for the construction,

reconstruction, or acquisition of qualified property described in the original binding contract and to costs for the construction, reconstruction, or acquisition of qualified property not described in the original binding contract, then the portion of those amounts described in the successor or replacement contract that were not described in the original binding contract shall not be treated as costs paid or incurred pursuant to a binding contract in existence on or prior to January 1, 1994, under subparagraph (A) of paragraph (1).

(3) (A) For purposes of this section, an option contract in existence prior to January 1, 1994, under which a qualified taxpayer (or any other person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) had an option to acquire qualified property, shall be treated as a binding contract under the rules in paragraph (2). For purposes of this subparagraph, an option contract shall not include an option under which the optionholder will forfeit an amount less than 10 percent of the fixed option price in the event the option is not exercised.

(B) For purposes of this section, a contract shall be treated as binding even if the contract is subject to a condition.

(4) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, “the first taxable year beginning on or after January 1, 1998,” shall be substituted for “January 1, 1994,” in each place in which it appears.

(c) (1) For purposes of this section, “qualified taxpayer” means any taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer under this section shall be made at the entity level and any credit under this section or Section 23649 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section

1 17001) or Part 11 (commencing with Section 23001). For purposes
2 of this paragraph, the term “passthrough entity” means any
3 partnership or S corporation.

4 (3) The Franchise Tax Board may prescribe regulations to carry
5 out the purposes of this section, including any regulations
6 necessary to prevent the avoidance of the effect of this section
7 through splitups, shell corporations, partnerships, tiered
8 ownership structures, sale-leaseback transactions, or otherwise.

9 (d) For purposes of this section, “qualified property” means
10 property that is described as any of the following:

11 (1) Tangible personal property that is defined in Section
12 1245(a) of the Internal Revenue Code for use by a qualified
13 taxpayer in those lines of business described in Codes 2011 to
14 3999, inclusive, of the Standard Industrial Classification (SIC)
15 Manual published by the United States Office of Management and
16 Budget, 1987 edition, that is primarily used for any of the
17 following:

18 (A) For the manufacturing, processing, refining, fabricating, or
19 recycling of property, beginning at the point at which any raw
20 materials are received by the qualified taxpayer and introduced
21 into the process and ending at the point at which the
22 manufacturing, processing, refining, fabricating, or recycling has
23 altered tangible personal property to its completed form, including
24 packaging, if required.

25 (B) In research and development.

26 (C) To maintain, repair, measure, or test any property described
27 in this paragraph.

28 (D) For pollution control that meets or exceeds standards
29 established by the state or by any local or regional governmental
30 agency within the state.

31 (E) For recycling.

32 (2) Computers and computer peripheral equipment, as defined
33 in Section 168(i)(2)(B) of the Internal Revenue Code, that is
34 tangible personal property as defined in Section 1245(a) of the
35 Internal Revenue Code for use by a qualified taxpayer in those
36 lines of business described in SIC Codes 7371 to 7373, inclusive,
37 of the SIC Manual, 1987 edition, that is primarily used to develop
38 or manufacture prepackaged software or custom software
39 prepared to the special order of the purchaser who uses the



1 program to produce and sell or license copies of the program as
2 prepackaged software.

3 (3) The value of any capitalized labor costs that are directly
4 allocable to the construction or modification of property described
5 in paragraph (1) or (2).

6 (4) In the case of any qualified taxpayer engaged in
7 manufacturing activities described in SIC Code 357 or 367, those
8 activities related to biotechnology described in SIC Code 8731,
9 those activities related to biopharmaceutical establishments only
10 that are described in SIC Codes 2833 to 2836, inclusive, those
11 activities related to space vehicles and parts described in SIC
12 Codes 3761 to 3769, inclusive, those activities related to space
13 satellites and communications satellites and equipment described
14 in SIC Codes 3663 and 3812 (but only with respect to “qualified
15 property” that is placed in service on or after January 1, 1996), or
16 those activities related to semiconductor equipment
17 manufacturing described in SIC Code 3559 (but only with respect
18 to “qualified property” that is placed in service on or after January
19 1, 1997), “qualified property” also includes the following:

20 (A) Special purpose buildings and foundations that are
21 constructed or modified for use by the qualified taxpayer primarily
22 in a manufacturing, processing, refining, or fabricating process, or
23 as a research or storage facility primarily used in connection with
24 a manufacturing process.

25 (B) The value of any capitalized labor costs that are directly
26 allocable to the construction or modification of special purpose
27 buildings and foundations that are used primarily in the
28 manufacturing, processing, refining, or fabricating process, or as
29 a research or storage facility primarily used in connection with a
30 manufacturing process.

31 (C) (i) For purposes of this paragraph, “special purpose
32 building and foundation” means only a building and the
33 foundation immediately underlying the building that is
34 specifically designed and constructed or reconstructed for the
35 installation, operation, and use of specific machinery and
36 equipment with a special purpose, which machinery and
37 equipment, after installation, will become affixed to or a fixture of
38 the real property, and the construction or reconstruction of which
39 is specifically designed and used exclusively for the specified
40 purposes as set forth in subparagraph (A) (“qualified purpose”).

1 (ii) A building is specifically designed and constructed or
2 modified for a qualified purpose if it is not economical to design
3 and construct the building for the intended purpose and then use
4 the structure for a different purpose.

5 (iii) For purposes of clause (i) and clause (vi), a building is used
6 exclusively for a qualified purpose only if its use does not include
7 a use for which it was not specifically designed and constructed or
8 modified. Incidental use of a building for nonqualified purposes
9 does not preclude the building from being a special purpose
10 building. “Incidental use” means a use which is both related and
11 subordinate to the qualified purpose. It will be conclusively
12 presumed that a use is not subordinate if more than one-third of the
13 total usable volume of the building is devoted to a use which is not
14 a qualified purpose.

15 (iv) In the event an entire building does not qualify as a special
16 purpose building, a taxpayer may establish that a portion of a
17 building, and the foundation immediately underlying the portion,
18 qualifies for treatment as a special purpose building and
19 foundation if the portion satisfies all of the definitional provisions
20 in this subparagraph.

21 (v) To the extent that a building is not a special purpose
22 building as defined above, but a portion of the building qualifies
23 for treatment as a special purpose building, then all equipment
24 which exclusively supports the qualified purpose occurring within
25 that portion and which would qualify as Internal Revenue Code
26 Section 1245 property if it were not a fixture or affixed to the
27 building shall be treated as a cost of the portion of the building
28 which qualifies for treatment as a special purpose building.

29 (vi) Buildings and foundations which do not meet the
30 definition of a special purpose building and foundation set forth
31 above include, but are not limited to: buildings designed and
32 constructed or reconstructed principally to function as a general
33 purpose manufacturing, industrial, or commercial building;
34 research facilities that are used primarily prior to or after, or prior
35 to and after, the manufacturing process; or storage facilities that
36 are used primarily prior to or after, or prior to and after, completion
37 of the manufacturing process. A research facility shall not be
38 considered to be used primarily prior to or after, or prior to and
39 after, the manufacturing process if its purpose and use relate
40 exclusively to the development and regulatory approval of the



1 manufacturing process for specific biopharmaceutical products. A
2 research facility which is used primarily in connection with the
3 discovery of an organism from which a biopharmaceutical product
4 or process is developed does not meet the requirements of the
5 preceding sentence.

6 (5) Subject to the provisions in subparagraph (B) of paragraph
7 (1) of subdivision (b), qualified property also includes computer
8 software that is primarily used for those purposes set forth in
9 paragraph (1) or (2) of this subdivision.

10 (6) Qualified property does not include any of the following:

11 (A) Furniture.

12 (B) Facilities used for warehousing purposes after completion
13 of the manufacturing process.

14 (C) Inventory.

15 (D) Equipment used in the extraction process.

16 (E) Equipment used to store finished products that have
17 completed the manufacturing process.

18 (F) Any tangible personal property that is used in
19 administration, general management, or marketing.

20 ~~(G) Any vehicle for which a credit is claimed pursuant to~~
21 ~~Section 17052.11 or 23603.~~

22 (e) For purposes of this section:

23 (1) “Biopharmaceutical activities” means those activities that
24 use organisms or materials derived from organisms, and their
25 cellular, subcellular, or molecular components, in order to provide
26 pharmaceutical products for human or animal therapeutics and
27 diagnostics. Biopharmaceutical activities make use of living
28 organisms to make commercial products, as opposed to
29 pharmaceutical activities which make use of chemical compounds
30 to produce commercial products.

31 (2) “Fabricating” means to make, build, create, produce, or
32 assemble components or property to work in a new or different
33 manner.

34 (3) “Manufacturing” means the activity of converting or
35 conditioning property by changing the form, composition, quality,
36 or character of the property for ultimate sale at retail or use in the
37 manufacturing of a product to be ultimately sold at retail.
38 Manufacturing includes any improvements to tangible personal
39 property that result in a greater service life or greater functionality
40 than that of the original property.

(4) “Other biotechnology activities” means activities consisting of the application of recombinant DNA technology to produce commercial products, as well as activities regarding pharmaceutical delivery systems designed to provide a measure of control over the rate, duration, and site of pharmaceutical delivery.

(5) “Primarily” means tangible personal property used 50 percent or more of the time in an activity described in subdivision (d).

(6) “Process” means the period beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling activity of the qualified taxpayer has altered tangible personal property to its completed form, including packaging, if required. Raw materials shall be considered to have been introduced into the process when the raw materials are stored on the same premises where the qualified taxpayer’s manufacturing, processing, refining, or recycling activity is conducted. Raw materials that are stored on premises other than where the qualified taxpayer’s manufacturing, processing, refining, fabricating, or recycling activity is conducted, shall not be considered to have been introduced into the manufacturing, processing, refining, fabricating, or recycling process.

(7) “Processing” means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) “Refining” means the process of converting a natural resource to an intermediate or finished product.

(9) “Research and development” means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) “Small business” means a qualified taxpayer that meets any of the following requirements during the taxable year for which the credit is allowed:

(A) Has gross receipts of less than fifty million dollars (\$50,000,000).

(B) Has net assets of less than fifty million dollars (\$50,000,000).

1 (C) Has a total credit of less than one million dollars
2 (\$1,000,000).

3 (D) For taxable years beginning on or after January 1, 1997, is
4 engaged in biopharmaceutical activities or other biotechnology
5 activities that are described in Codes 2833 to 2836, inclusive, of
6 the Standard Industrial Classification (SIC) Manual published by
7 the United States Office of Management and Budget, 1987 edition,
8 and has not received regulatory approval for any product from the
9 United States Food and Drug Administration.

10 (f) The credit allowed under subdivision (a) shall apply to
11 qualified property that is acquired by or subject to lease by a
12 qualified taxpayer, subject to the following special rules:

13 (1) A lessor of qualified property, irrespective of whether the
14 lessor is a qualified taxpayer, shall not be allowed the credit
15 provided under subdivision (a) with respect to any qualified
16 property leased to another qualified taxpayer.

17 (2) For purposes of paragraphs (2) and (3) of subdivision (b),
18 “binding contract” shall include any lease agreement with respect
19 to the qualified property.

20 (3) (A) For purposes of determining the qualified cost paid or
21 incurred by a lessee in any leasing transaction that is not treated as
22 a sale under Part 1 (commencing with Section 6001), the following
23 rules shall apply:

24 (i) Except as provided by subparagraph (C) of this paragraph,
25 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)
26 shall not apply.

27 (ii) Except as provided in subparagraph (B) and clause (iii), the
28 “qualified cost” upon which the lessee shall compute the credit
29 provided under this section shall be equal to the original cost to the
30 lessor (within the meaning of Section 18031) of the qualified
31 property that is the subject of the lease.

32 (iii) Except as provided in clause (iv), the requirement of
33 subparagraph (B) of paragraph (1) of subdivision (b) shall be
34 treated as satisfied only if the lessor has made a timely election
35 under either Section 6094.1 or subdivision (d) of Section 6244 and
36 has paid sales tax reimbursement or use tax measured by the
37 purchase price of the qualified property (within the meaning of
38 paragraph (5) of subdivision (g) of Section 6006). For purposes of
39 this subdivision and clause (iv), the amount of original cost to the
40 lessor which may be taken into account under clause (ii) shall not

1 exceed the purchase price upon which sales tax reimbursement or
2 use tax has been paid under the preceding sentence or under clause
3 (iv).

4 (iv) With respect to leases entered into between January 1,
5 1994, and the effective date of this clause, the lessor may elect to
6 pay use tax measured by the purchase price of the property by
7 reporting and paying the tax with the return of the lessor for the
8 fourth calendar quarter of 1994. In computing the use tax under the
9 preceding sentence, a credit shall be allowed under Part 1
10 (commencing with Section 6001) for all sales or use tax previously
11 paid on the lease.

12 (B) For purposes of applying subparagraph (A) only, the
13 following special rules shall apply:

14 (i) The original cost to the lessor of the qualified property shall
15 be reduced by the amount of any original cost of that property that
16 was taken into account by any predecessor lessee in computing the
17 credit allowable under this section.

18 (ii) Clause (i) shall not apply in any case where the predecessor
19 lessee was required to recapture the credit provided under this
20 section pursuant to subdivision (g).

21 (iii) For purposes of this section only, in any case where a
22 successor lessor has acquired qualified property from a
23 predecessor lessor in a transaction not treated as a sale under Part
24 1 (commencing with Section 6001), the original cost to the
25 successor lessor of the qualified property shall be reduced by the
26 amount of the original cost of the qualified property that was taken
27 into account by any lessee of the predecessor lessor in computing
28 the credit allowable under this section.

29 (C) In determining the original cost of any qualified property
30 under this paragraph, only amounts paid or incurred by the lessor
31 on or after January 1, 1994, and prior to the date this section ceases
32 to be operative under paragraph (2) of subdivision (i), shall be
33 taken into account. In the case of any qualified property
34 constructed, reconstructed, or acquired by a lessor pursuant to a
35 binding contract in existence on or prior to January 1, 1994, the
36 allocation rule specified in subparagraph (A) of paragraph (1) of
37 subdivision (b) shall apply in determining the original cost to the
38 lessor of qualified property.

39 (D) Notwithstanding subparagraph (A), in the case of any
40 leasing transaction for which the lessee is allowed the credit under

1 this section and thereafter the lessee (or any party related to the
2 lessee within the meaning of Section 267 or 318 of the Internal
3 Revenue Code) acquires the qualified property from the lessor (or
4 any successor lessor) within one year from the date the qualified
5 property is first used by the lessee under the terms of the lease, the
6 lessee's (or related party's) acquisition of the qualified property
7 from the lessor (or successor lessor) shall be treated as a
8 disposition by the lessee of the qualified property that was subject
9 to the lease under subdivision (g).

10 (4) For purposes of determining the qualified cost paid or
11 incurred by a lessee in any leasing transaction that is treated as a
12 sale under Part 1 (commencing with Section 6001), the following
13 rules shall apply:

14 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall
15 be applied by substituting the term "purchase" for the term
16 "construction, reconstruction, or acquisition."

17 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall
18 apply.

19 (C) The requirement of subparagraph (B) of paragraph (1) of
20 subdivision (b) shall be treated as satisfied at the time that either
21 the lessor or the qualified taxpayer pays sales or use tax under Part
22 1 (commencing with Section 6001).

23 (5) (A) In the case of any leasing transaction described in
24 paragraph (3), the lessor shall provide a statement to the lessee
25 specifying the amount of the lessor's original cost of the qualified
26 property and the amount of that cost upon which a sales or use tax
27 was paid within 45 days after the close of the lessee's taxable year
28 in which the credit is allowable to the lessee under this section.

29 (B) The statement required under subparagraph (A) shall be
30 made available to the Franchise Tax Board upon request.

31 (6) For purposes of this subdivision, in the case of any qualified
32 taxpayer engaged in those lines of business described in Codes
33 7371 to 7373, inclusive, of the Standard Industrial Classification
34 (SIC) Manual published by the United States Office of
35 Management and Budget, 1987 edition, "the first taxable year
36 beginning on or after January 1, 1998," shall be substituted for
37 "January 1, 1994," in each place in which it appears. In addition,
38 "the effective date of this paragraph" shall be substituted for "the
39 effective date of this clause" and "fourth calendar quarter of
40 1998" shall be substituted for "fourth calendar quarter of 1994."

1 (g) No credit shall be allowed if the qualified property is
2 removed from the state, is disposed of to an unrelated party, or is
3 used for any purpose not qualifying for the credit provided in this
4 section in the same taxable year in which the qualified property is
5 first placed in service in this state. If any qualified property for
6 which a credit is allowed pursuant to this section is thereafter
7 removed from this state, disposed of to an unrelated party, or used
8 for any purpose not qualifying for the credit provided in this
9 section within one year from the date the qualified property is first
10 placed in service in this state, the amount of the credit allowed by
11 this section for that qualified property shall be recaptured by
12 adding that credit amount to the net tax of the qualified taxpayer
13 for the taxable year in which the qualified property is disposed of,
14 removed, or put to an ineligible use.

15 (h) In the case where the credit allowed by this section exceeds
16 the “net tax,” the excess may be carried over to reduce the “net
17 tax” in the following year, and succeeding years as follows:

18 (1) Except as provided in paragraph (2), for the seven
19 succeeding years if necessary, until the credit is exhausted.

20 (2) In the case of a small business, for the nine succeeding
21 years, if necessary, until the credit is exhausted.

22 (i) (1) This section shall remain in effect until the date
23 specified in paragraph (2), on which date this section shall cease
24 to be operative, and as of that date is repealed.

25 (2) (A) This section shall cease to be operative on January 1,
26 2001, or on January 1 of the earliest year thereafter, if the total
27 employment in this state, as determined by the Employment
28 Development Department on the preceding January 1, does not
29 exceed by 100,000 jobs the total employment in this state on
30 January 1, 1994. The department shall report to the Legislature
31 annually with respect to the determination required by the
32 preceding sentence.

33 (B) For purposes of this paragraph, “total employment” means
34 the total employment in the manufacturing sector, excluding
35 employment in the aerospace sector.

36 (j) The amendments made by the act adding this subdivision
37 shall be operative for taxable years beginning on or after January
38 1, 1997, except as provided in paragraph (3) of subdivision (d).

(k) The amendments made by the act adding this subdivision shall be operative for taxable years beginning on or after January 1, 1998.

SEC. 3. Section 23649 of the Revenue and Taxation Code is amended to read:

23649. (a) (1) A qualified taxpayer shall be allowed a credit against the “tax,” as defined in Section 23036, equal to 6 percent of the qualified cost of qualified property that is placed in service in this state.

(2) In the case of any qualified costs paid or incurred on or after January 1, 1994, and prior to the first taxable year of the qualified taxpayer beginning on or after January 1, 1995, the credit provided under paragraph (1) shall be claimed by the qualified taxpayer on the qualified taxpayer’s return for the first taxable year beginning on or after January 1, 1995. No credit shall be claimed under this section on a return filed for any taxable year commencing prior to the qualified taxpayer’s first taxable year beginning on or after January 1, 1995.

(b) (1) For purposes of this section, “qualified cost” means any cost that satisfies each of the following conditions:

(A) Except as otherwise provided in this subparagraph, is a cost paid or incurred by the qualified taxpayer for the construction, reconstruction, or acquisition of qualified property on or after January 1, 1994, and prior to the date this section ceases to be operative under paragraph (2) of subdivision (i). In the case of any qualified property constructed, reconstructed, or acquired by the qualified taxpayer (or any person related to the qualified taxpayer within the meaning of Section 267 or 707 of the Internal Revenue Code) pursuant to a binding contract in existence on or prior to January 1, 1994, costs paid pursuant to that contract shall be subject to allocation as follows: contract costs shall be allocated to qualified property based on a ratio of costs actually paid prior to January 1, 1994, and total contract costs actually paid. “Cost paid” shall include, without limitation, contractual deposits and option payments. To the extent of cost allocated, whether or not currently deductible or depreciable for tax purposes, to a period prior to January 1, 1994, the cost shall be deemed allocated to property acquired before January 1, 1994, and is thus not a “qualified cost.”

(B) ~~Except as provided in paragraph (3) of subdivision (d) and subparagraph (B) of paragraph (4) of subdivision (d), is an amount~~

1 ~~upon which the qualified taxpayer has paid, directly or indirectly~~
2 ~~as a separately stated contract amount or as determined from the~~
3 ~~records of the qualified taxpayer, sales or use tax under Part 1~~
4 ~~(commencing with Section 6001).~~

5 ~~(C)~~—Is an amount properly chargeable to the capital account of
6 the qualified taxpayer.

7 (2) (A) For purposes of this subdivision, any contract entered
8 into on or after January 1, 1994, that is a successor or replacement
9 contract to a contract that was binding prior to January 1, 1994,
10 shall be treated as a binding contract in existence prior to January
11 1, 1994.

12 (B) If a successor or replacement contract is entered into on or
13 after January 1, 1994, and the subject of the successor or
14 replacement contract relates both to amounts for the construction,
15 reconstruction, or acquisition of qualified property described in
16 the original binding contract and to costs for the construction,
17 reconstruction, or acquisition of qualified property not described
18 in the original binding contract, then the portion of those amounts
19 described in the successor or replacement contract that were not
20 described in the original binding contract shall not be treated as
21 costs paid or incurred pursuant to a binding contract in existence
22 on or prior to January 1, 1994, under subparagraph (A) of
23 paragraph (1).

24 (3) (A) For purposes of this section, an option contract in
25 existence prior to January 1, 1994, under which a qualified
26 taxpayer (or any other person related to the qualified taxpayer
27 within the meaning of Section 267 or 707 of the Internal Revenue
28 Code) had an option to acquire qualified property, shall be treated
29 as a binding contract under the rules in paragraph (2). For purposes
30 of this subparagraph, an option contract shall not include an option
31 under which the optionholder will forfeit an amount less than 10
32 percent of the fixed option price in the event the option is not
33 exercised.

34 (B) For purposes of this section, a contract shall be treated as
35 binding even if the contract is subject to a condition.

36 (4) For purposes of this subdivision, in the case of any qualified
37 taxpayer engaged in those lines of business described in Codes
38 7371 to 7373, inclusive, of the Standard Industrial Classification
39 (SIC) Manual published by the United States Office of
40 Management and Budget, 1987 edition, “the first taxable year

beginning on or after January 1, 1998,” shall be substituted for “January 1, 1994,” in each place in which it appears.

(c) (1) For purposes of this section, “qualified taxpayer” means any taxpayer engaged in those lines of business described in Codes 2011 to 3999, inclusive, or Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition.

(2) In the case of any passthrough entity, the determination of whether a taxpayer is a qualified taxpayer shall be made at the entity level and any credit under this section or Section 17053.49 shall be allowed to the passthrough entity and passed through to the partners or shareholders in accordance with applicable provisions of Part 10 (commencing with Section 17001) or Part 11 (commencing with Section 23001). For purposes of this paragraph, the term “passthrough entity” means any partnership or S corporation.

(3) The Franchise Tax Board may prescribe regulations to carry out the purposes of this section, including any regulations necessary to prevent the avoidance of the effect of this section through splitups, shell corporations, partnerships, tiered ownership structures, sale-leaseback transactions, or otherwise.

(d) For purposes of this section, “qualified property” means property that is described as either of the following:

(1) Tangible personal property that is defined in Section 1245(a) of the Internal Revenue Code for use by a qualified taxpayer in those lines of business described in Codes 2011 to 3999, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, that is primarily used for any of the following:

(A) For the manufacturing, processing, refining, fabricating, or recycling of property, beginning at the point at which any raw materials are received by the qualified taxpayer and introduced into the process and ending at the point at which the manufacturing, processing, refining, fabricating, or recycling has altered tangible personal property to its completed form, including packaging, if required.

(B) In research and development.

1 (C) To maintain, repair, measure, or test any property described
2 in this paragraph.

3 (D) For pollution control that meets or exceeds standards
4 established by the state or by any local or regional governmental
5 agency within the state.

6 (E) For recycling.

7 (2) Computers and computer peripheral equipment, as defined
8 in Section 168(i)(2)(B) of the Internal Revenue Code, that is
9 tangible personal property as defined in Section 1245(a) of the
10 Internal Revenue Code for use by a qualified taxpayer in those
11 lines of business described in SIC Codes 7371 to 7373, inclusive,
12 of the SIC Manual, 1987 edition, that is primarily used to develop
13 or manufacture prepackaged software or custom software
14 prepared to the special order of the purchaser who uses the
15 program to produce and sell or license copies of the program as
16 prepackaged software.

17 (3) The value of any capitalized labor costs that are directly
18 allocable to the construction or modification of property described
19 in paragraph (1) or (2).

20 (4) In the case of any qualified taxpayer engaged in
21 manufacturing activities described in SIC Code 357 or 367, those
22 activities related to biotechnology described in SIC Code 8731,
23 those activities related to biopharmaceutical establishments only
24 that are described in SIC Codes 2833 to 2836, inclusive, those
25 activities related to space vehicles and parts described in SIC
26 Codes 3761 to 3769, inclusive, those activities related to space
27 satellites and communications satellites and equipment described
28 in SIC Codes 3663 and 3812 (but only with respect to “qualified
29 property” that is placed in service on or after January 1, 1996), or
30 those activities related to semiconductor equipment
31 manufacturing described in SIC Code 3559 (but only with respect
32 to “qualified property” that is placed in service on or after January
33 1, 1997), “qualified property” also includes the following:

34 (A) Special purpose buildings and foundations that are
35 constructed or modified for use by the qualified taxpayer primarily
36 in a manufacturing, processing, refining, or fabricating process, or
37 as a research or storage facility primarily used in connection with
38 a manufacturing process.

39 (B) The value of any capitalized labor costs that are directly
40 allocable to the construction or modification of special purpose

buildings and foundations that are used primarily in the manufacturing, processing, refining, or fabricating process, or as a research or storage facility primarily used in connection with a manufacturing process.

(C) (i) For purposes of this paragraph, “special purpose building and foundation” means only a building and the foundation immediately underlying the building that is specifically designed and constructed or reconstructed for the installation, operation, and use of specific machinery and equipment with a special purpose, which machinery and equipment, after installation, will become affixed to or a fixture of the real property, and the construction or reconstruction of which is specifically designed and used exclusively for the specified purposes as set forth in subparagraph (A) (“qualified purpose”).

(ii) A building is specifically designed and constructed or modified for a qualified purpose if it is not economical to design and construct the building for the intended purpose and then use the structure for a different purpose.

(iii) For purposes of clause (i) and clause (vi), a building is used exclusively for a qualified purpose only if its use does not include a use for which it was not specifically designed and constructed or modified. Incidental use of a building for nonqualified purposes does not preclude the building from being a special purpose building. “Incidental use” means a use which is both related and subordinate to the qualified purpose. It will be conclusively presumed that a use is not subordinate if more than one-third of the total usable volume of the building is devoted to a use which is not a qualified purpose.

(iv) In the event an entire building does not qualify as a special purpose building, a taxpayer may establish that a portion of a building, and the foundation immediately underlying the portion, qualifies for treatment as a special purpose building and foundation if the portion satisfies all of the definitional provisions in this subparagraph.

(v) To the extent that a building is not a special purpose building as defined above, but a portion of the building qualifies for treatment as a special purpose building, then all equipment which exclusively supports the qualified purpose occurring within that portion and which would qualify as Internal Revenue Code Section 1245 property if it were not a fixture or affixed to the

1 building shall be treated as a cost of the portion of the building
2 which qualifies for treatment as a special purpose building.

3 (vi) Buildings and foundations which do not meet the
4 definition of a special purpose building and foundation set forth
5 above include, but are not limited to: buildings designed and
6 constructed or reconstructed principally to function as a general
7 purpose manufacturing, industrial, or commercial building;
8 research facilities that are used primarily prior to or after, or prior
9 to and after, the manufacturing process; or storage facilities that
10 are used primarily prior to or after, or prior to and after, completion
11 of the manufacturing process. A research facility shall not be
12 considered to be used primarily prior to or after, or prior to and
13 after, the manufacturing process if its purpose and use relate
14 exclusively to the development and regulatory approval of the
15 manufacturing process for specific biopharmaceutical products. A
16 research facility which is used primarily in connection with the
17 discovery of an organism from which a biopharmaceutical product
18 or process is developed does not meet the requirements of the
19 preceding sentence.

20 (5) Subject to the provisions in subparagraph (B) of paragraph
21 (1) of subdivision (b), qualified property also includes computer
22 software that is primarily used for those purposes set forth in
23 paragraph (1) or (2) of this subdivision.

24 (6) Qualified property does not include any of the following:

25 (A) Furniture.

26 (B) Facilities used for warehousing purposes after completion
27 of the manufacturing process.

28 (C) Inventory.

29 (D) Equipment used in the extraction process.

30 (E) Equipment used to store finished products that have
31 completed the manufacturing process.

32 (F) Any tangible personal property that is used in
33 administration, general management, or marketing.

34 ~~(G) Any vehicle for which a credit is claimed pursuant to~~
35 ~~Section 17052.11 or 23603.~~

36 (e) For purposes of this section:

37 (1) “Biopharmaceutical activities” means those activities that
38 use organisms or materials derived from organisms, and their
39 cellular, subcellular, or molecular components, in order to provide
40 pharmaceutical products for human or animal therapeutics and

1 diagnostics. Biopharmaceutical activities make use of living
2 organisms to make commercial products, as opposed to
3 pharmaceutical activities which make use of chemical compounds
4 to produce commercial products.

5 (2) “Fabricating” means to make, build, create, produce, or
6 assemble components or property to work in a new or different
7 manner.

8 (3) “Manufacturing” means the activity of converting or
9 conditioning property by changing the form, composition, quality,
10 or character of the property for ultimate sale at retail or use in the
11 manufacturing of a product to be ultimately sold at retail.
12 Manufacturing includes any improvements to tangible personal
13 property that result in a greater service life or greater functionality
14 than that of the original property.

15 (4) “Other biotechnology activities” means activities
16 consisting of the application of recombinant DNA technology to
17 produce commercial products, as well as activities regarding
18 pharmaceutical delivery systems designed to provide a measure of
19 control over the rate, duration, and site of pharmaceutical delivery.

20 (5) “Primarily” means tangible personal property used 50
21 percent or more of the time in an activity described in subdivision
22 (d).

23 (6) “Process” means the period beginning at the point at which
24 any raw materials are received by the qualified taxpayer and
25 introduced into the manufacturing, processing, refining,
26 fabricating, or recycling activity of the qualified person and
27 ending at the point at which the manufacturing, processing,
28 refining, fabricating, or recycling activity of the qualified taxpayer
29 has altered tangible personal property to its completed form,
30 including packaging, if required. Raw materials shall be
31 considered to have been introduced into the process when the raw
32 materials are stored on the same premises where the qualified
33 taxpayer’s manufacturing, processing, refining, fabricating, or
34 recycling activity is conducted. Raw materials that are stored on
35 premises other than where the qualified taxpayer’s manufacturing,
36 processing, refining, fabricating, or recycling activity is
37 conducted, shall not be considered to have been introduced into the
38 manufacturing, processing, refining, fabricating, or recycling
39 process.

(7) “Processing” means the physical application of the materials and labor necessary to modify or change the characteristics of property.

(8) “Refining” means the process of converting a natural resource to an intermediate or finished product.

(9) “Research and development” means those activities that are described in Section 174 of the Internal Revenue Code or in any regulations thereunder.

(10) “Small business” means a qualified taxpayer that meets any of the following requirements during the taxable year for which the credit is allowed:

(A) Has gross receipts of less than fifty million dollars (\$50,000,000).

(B) Has net assets of less than fifty million dollars (\$50,000,000).

(C) Has a total credit of less than one million dollars (\$1,000,000).

(D) For taxable years beginning on or after January 1, 1997, is engaged in biopharmaceutical activities or other biotechnology activities that are described in Codes 2833 to 2836, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, and has not received regulatory approval for any product from the United States Food and Drug Administration.

(f) The credit allowed under subdivision (a) shall apply to qualified property that is acquired by or subject to lease by a qualified taxpayer, subject to the following special rules:

(1) A lessor of qualified property, irrespective of whether the lessor is a qualified taxpayer, shall not be allowed the credit provided under subdivision (a) with respect to any qualified property leased to another qualified taxpayer.

(2) For purposes of paragraphs (2) and (3) of subdivision (b), “binding contract” shall include any lease agreement with respect to the qualified property.

(3) (A) For purposes of determining the qualified cost paid or incurred by a lessee in any leasing transaction that is not treated as a sale under Part 1 (commencing with Section 6001), the following rules shall apply:

1 (i) Except as provided by subparagraph (C) of this paragraph,
2 subparagraphs (A) and (C) of paragraph (1) of subdivision (b)
3 shall not apply.

4 (ii) Except as provided in subparagraph (B) and clause (iii), the
5 “qualified cost” upon which the lessee shall compute the credit
6 provided under this section shall be equal to the original cost to the
7 lessor (within the meaning of Section 24912) of the qualified
8 property that is the subject of the lease.

9 (iii) Except as provided in clause (iv), the requirement of
10 subparagraph (B) of paragraph (1) of subdivision (b) shall be
11 treated as satisfied only if the lessor has made a timely election
12 under either Section 6094.1 or subdivision (d) of Section 6244 and
13 has paid sales tax reimbursement or use tax measured by the
14 purchase price of the qualified property (within the meaning of
15 paragraph (5) of subdivision (g) of Section 6006). For purposes of
16 this subdivision and clause (iv), the amount of original cost to the
17 lessor which may be taken into account under clause (ii) shall not
18 exceed the purchase price upon which sales tax reimbursement or
19 use tax has been paid under the preceding sentence or under clause
20 (iv).

21 (iv) With respect to leases entered into between January 1,
22 1994, and the effective date of this clause, the lessor may elect to
23 pay use tax measured by the purchase price of the property by
24 reporting and paying the tax with the return of the lessor for the
25 fourth calendar quarter of 1994. In computing the use tax under the
26 preceding sentence, a credit shall be allowed under Part 1
27 (commencing with Section 6001) for all sales or use tax previously
28 paid on the lease.

29 (B) For purposes of applying subparagraph (A) only, the
30 following special rules shall apply:

31 (i) The original cost to the lessor of the qualified property shall
32 be reduced by the amount of any original cost of that property that
33 was taken into account by any predecessor lessee in computing the
34 credit allowable under this section.

35 (ii) Clause (i) shall not apply in any case where the predecessor
36 lessee was required to recapture the credit provided under this
37 section pursuant to subdivision (g).

38 (iii) For purposes of this section only, in any case where a
39 successor lessor has acquired qualified property from a
40 predecessor lessor in a transaction not treated as a sale under Part

1 1 (commencing with Section 6001), the original cost to the
2 successor lessor of the qualified property shall be reduced by the
3 amount of the original cost of the qualified property that was taken
4 into account by any lessee of the predecessor lessor in computing
5 the credit allowable under this section.

6 (C) In determining the original cost of any qualified property
7 under this paragraph, only amounts paid or incurred by the lessor
8 on or after January 1, 1994, and prior to the date this section ceases
9 to be operative under paragraph (2) of subdivision (i), shall be
10 taken into account. In the case of any qualified property
11 constructed, reconstructed, or acquired by a lessor pursuant to a
12 binding contract in existence on or prior to January 1, 1994, the
13 allocation rule specified in subparagraph (A) of paragraph (1) of
14 subdivision (b) shall apply in determining the original cost to the
15 lessor of qualified property.

16 (D) Notwithstanding subparagraph (A), in the case of any
17 leasing transaction for which the lessee is allowed the credit under
18 this section and thereafter the lessee (or any party related to the
19 lessee within the meaning of Section 267 or 318 of the Internal
20 Revenue Code) acquires the qualified property from the lessor (or
21 any successor lessor) within one year from the date the qualified
22 property is first used by the lessee under the terms of the lease, the
23 lessee's (or related party's) acquisition of the qualified property
24 from the lessor (or successor lessor) shall be treated as a
25 disposition by the lessee of the qualified property that was subject
26 to the lease under subdivision (g).

27 (4) For purposes of determining the qualified cost paid or
28 incurred by a lessee in any leasing transaction that is treated as a
29 sale under Part 1 (commencing with Section 6001), the following
30 rules shall apply:

31 (A) Subparagraph (A) of paragraph (1) of subdivision (b) shall
32 be applied by substituting the term "purchase" for the term
33 "construction, reconstruction, or acquisition."

34 (B) Subparagraph (C) of paragraph (1) of subdivision (b) shall
35 apply.

36 (C) The requirement of subparagraph (B) of paragraph (1) of
37 subdivision (b) shall be treated as satisfied at the time that either
38 the lessor or the qualified taxpayer pays sales or use tax under Part
39 1 (commencing with Section 6001).

(5) (A) In the case of any leasing transaction described in paragraph (3), the lessor shall provide a statement to the lessee specifying the amount of the lessor's original cost of the qualified property and the amount of that cost upon which a sales or use tax was paid within 45 days after the close of the lessee's taxable year in which the credit is allowable to the lessee under this section.

(B) The statement required under subparagraph (A) shall be made available to the Franchise Tax Board upon request.

(6) For purposes of this subdivision, in the case of any qualified taxpayer engaged in those lines of business described in Codes 7371 to 7373, inclusive, of the Standard Industrial Classification (SIC) Manual published by the United States Office of Management and Budget, 1987 edition, "the first taxable year beginning on or after January 1, 1998," shall be substituted for "January 1, 1994," in each place in which it appears. In addition, "the effective date of this paragraph" shall be substituted for "the effective date of this clause" and "fourth calendar quarter of 1998" shall be substituted for "fourth calendar quarter of 1994."

(g) No credit shall be allowed if the qualified property is removed from the state, is disposed of to an unrelated party, or is used for any purpose not qualifying for the credit provided in this section in the same taxable year in which the qualified property is first placed in service in this state. If any qualified property for which a credit is allowed pursuant to this section is thereafter removed from this state, disposed of to an unrelated party, or used for any purpose not qualifying for the credit provided in this section within one year from the date the qualified property is first placed in service in this state, the amount of the credit allowed by this section for that qualified property shall be recaptured by adding that credit amount to the net tax of the qualified taxpayer for the taxable year in which the qualified property is disposed of, removed, or put to an ineligible use. The sale of stock for which an election was made or deemed to have been made pursuant to Section 338(g) or 338(h)(10) of the Internal Revenue Code may not be treated as a disposition of qualified property to an unrelated party for purposes of this subdivision.

(h) In the case where the credit allowed by this section exceeds the "tax," the excess may be carried over to reduce the "tax" in the following year, and succeeding years as follows:

1 (1) Except as provided in paragraph (2), for the seven
2 succeeding years if necessary, until the credit is exhausted.

3 (2) In the case of a small business, for the nine succeeding
4 years, if necessary, until the credit is exhausted.

5 (i) (1) This section shall remain in effect until the date
6 specified in paragraph (2) on which date this section shall cease to
7 be operative, and as of that date is repealed.

8 (2) (A) This section shall cease to be operative on January 1,
9 2001, or on January 1 of the earliest year thereafter, if the total
10 employment in this state, as determined by the Employment
11 Development Department on the preceding January 1, does not
12 exceed by 100,000 jobs the total employment in this state on
13 January 1, 1994. The department shall report to the Legislature
14 annually with respect to the determination required by the
15 preceding sentence.

16 (B) For purposes of this paragraph, "total employment" means
17 the total employment in the manufacturing sector, excluding
18 employment in the aerospace sector.

19 (j) The amendments made by the act adding this subdivision
20 shall be operative for taxable years beginning on or after January
21 1, 1997, except as provided in paragraph (3) of subdivision (d).

22 (k) The amendments made by the act adding this subdivision
23 shall be operative for taxable years beginning on or after January
24 1, 1998.

25 SEC. 4. This act provides for a tax levy within the meaning of
26 Article IV of the Constitution and shall go into immediate effect.
27 However, Section 1 of this act shall not become operative until
28 January 1, 2004.